



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CHIEF COUNSEL

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CC:TEGE:EOEG:ET2

Mr. [REDACTED]

Dear Mr. [REDACTED]

This letter is in response to your inquiry dated June 21, 2002 to Senator Ernest P. Hollings. Senator Hollings asked that we respond to you directly concerning the IRS policy of estimating tips as described in the recent Supreme Court's decision in *United States v. Fior D'Italia, Inc.*, 122 S. Ct. 2117 (2002).

Employers must pay FICA taxes on wages and tips including unreported tips, which are wages for FICA purposes [Section 3121(q) of the Internal Revenue Code (the Code)]. Employees must report their tips to their employer, who then forwards the statements to the IRS and pays the employer's portion of the FICA tax. If the employee does not provide a statement of tips (or the statement is incomplete or inaccurate), the wages are deemed paid on the date the IRS gives notice and demand to the employer for the taxes. The employer must also report the amount of tips paid on credit cards.

In 1991 and 1992, Fior D'Italia, a restaurant in San Francisco, paid FICA taxes based on tips their employees reported. Fior D'Italia also reported the tips on customer credit card receipts, which far exceeded the amounts the employees reported. Because of the discrepancy, the IRS did a compliance check that led to an assessment of additional FICA taxes due from Fior D'Italia. The IRS did not audit the individual waiters/waitresses.

The IRS made the assessment using the "aggregate estimation" method to calculate the average percentage tip on credit card receipts and applied it to the cash sales. The IRS then added the estimated cash tips to the actual credit card tips to determine the estimated total tips received during 1991 and 1992. Finally, the IRS subtracted the amounts employees previously reported from the estimated total tips and assessed Fior D'Italia the additional taxes owed. The Supreme Court held that the IRS was within its rights to assess the additional FICA taxes against Fior D'Italia based on the "aggregate estimation" of tips.

Although some people are concerned about the use of the “aggregate estimation” of tips, the courts have consistently held that the IRS may estimate tax liability if the estimation is reasonably based. At trial, Fior D'Italia did not contest the estimated total tips as being inaccurate and agreed to the amount. The Supreme Court stated, “Absent such a stipulation, a taxpayer would remain free to present evidence that an assessment is inaccurate.... And we do not accept Fior D'Italia’s claim that restaurants are unable to do so....” The Court gave several ways restaurants could refute an IRS assessment. Thus, an employer can dispute an IRS assessment of tips.

You also recommend the Congress mandate that all restaurant workers receive the minimum wage, ban the “act of automatically collecting a tip,” and make tips tax free. Although we are sympathetic to your concerns, the issues you have raised are, unfortunately, outside the authority of the Internal Revenue Service, and would require legislative action.

We will make this letter available for public inspection after we delete names, addresses, and other identifying information, as appropriate, under the Freedom of Information Act.

I hope this information is helpful. If you have additional questions or if we can assist you further, please call me or [REDACTED] at [REDACTED]

Sincerely,

Lynne Camillo
Acting Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Government Entities)

cc: The Honorable Ernest P. Hollings